OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON ANALYZING WALL STREET ANALYSTS: ADDITIONAL PERSPECTIVES

TUESDAY, JULY 31, 2001

Mr. Chairman, today we meet for the second time to consider the issue of analyst independence, a subject of great significance to our nation's capital markets. Increasing the transparency of analysts' work should make it easier to detect faulty research, and it should enable investors to more easily evaluate the differing views of all analysts who cover a particular stock. Increased transparency should also help restore confidence in Wall Street research.

Since we last met on this subject in June, a number of developments directly affecting the subject of analyst independence have occurred. I therefore feel that I should summarize some of these events before we begin today's proceedings.

First, the National Association of Securities Dealers, or NASD, recently proposed changes to its disclosure rules. These amendments propose, among other things, to include common stock as a financial interest that firms and analysts must disclose. More importantly, the proposal would also require abbreviated disclosures during public appearances on radio and television shows. When implemented, these changes should help retail investors to better understand analyst conflicts. Officials with the NASD have also personally assured me that this rulemaking is not the last step that their organization will take to enhance analyst objectivity.

A number of securities firms have additionally announced revisions to their existing policies to manage analysts' conflicts. These changes exceed the recommendations for best practices announced by the Securities Industry Association at our last hearing. For example, at least three companies -- namely Merrill Lynch, Edward Jones, and Credit Suisse First Boston -- have announced plans in July to prohibit their analysts from owning securities in the companies they cover in their research. In the coming weeks, I expect that other firms will follow the lead of these companies by announcing changes to their own policies and practices designed to increase the independence of research.

Furthermore, the nation's largest brokerage firm announced that it had agreed to pay $400,000 to a pediatrician in Queens, New York, who claimed that he had lost more than $500,000 following the advice of his broker who regularly cited the bullish research of a prominent Wall Street analyst. Although this settlement established no legal precedent by itself, it does raise important ramifications for the brokerage business, especially if other investors in the weeks and months ahead pursue similar cases. I predict that just one or two more settlements of this type will create an incentive for the investment banks to take further action to improve the quality and trustworthiness of their research.

Although each of these actions demonstrates that the marketplace has begun to self-regulate on the issue of analyst objectivity, we must still do more. Mr. Chairman, in the weeks since our last hearing, the debate has intensified about whether we should privatize Social

Security. Social Security presently covers about 160 million workers. Because more than 20 percent of the adult American population is functionally illiterate, we can extrapolate that about 35 to 40 million working Americans cannot read or understand a business prospectus.

Yet we would be asking these very same individuals to make decisions about their retirement funds under Social Security privatization schemes. If they cannot read and comprehend a business plan or an accounting statement, it seems likely that many of these individuals would become excessively reliant on the advice of Wall Street researchers when making their investment decisions. Industry therefore has an obligation and a responsibility to comprehensively address the issue of analyst conflicts and resolve all related concerns before we begin any public policy debate on the future of Social Security.

That said, Mr. Chairman, today's hearing will further our understanding of the nature of this growing problem and help us to discover what other actions might restore the public's trust in analysts. As you know, I generally favor industry solving its own problems through the use of self-regulation whenever possible, and I was pleased to join with you in recent weeks in creating a review board to assess the adequacy of the industry reform proposals.

I will also listen carefully to today's testimony and continue to encourage our Committee to move deliberately on these matters in the months ahead. As I advised at our last hearing, we should not demagogue on the issue of analyst objectivity to score political points. Only cautious action on this subject will help to ensure that our capital markets remain strong and vibrant.

In closing, analyst independence is an issue of the utmost importance for maintaining the efficiency of and fairness in our nation's capital markets. Thank you again, Mr. Chairman, for the opportunity to raise my concerns before today's hearing.